No. 11923

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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HOWARD B. MORROW,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee,*

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## APPELLANT'S REPLY BRIEF.

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### I.

### Answer to Appellee's Argument That the Suit Was Not Premature and That the Question of Prematurity Is Moot.

1. Appellee contends that the bank's "consent, etc." did not extend the time of payment and had no effect upon the note or its due date, and that such "consent, etc." was merely a temporary waiver of a right to foreclose on one of two securities.

With this contention we cannot agree. The bank's "consent, etc" was a formal, written document, clearly and definitely binding the bank to withhold foreclosure upon the chattel mortgage during the existence of the joint adventure. Since only one action can be brought upon the note (Code Civ. Proc. 726), which action must be one for

the foreclosure of the mortgage, no cause of action arose upon the note either as against the maker or guarantor during the period of the joint adventure. This action was premature at the time the complaint was filed and is still premature.

2. It is not material that the guarantor, by language in the guarantee, waived his right to require the bank to proceed against the borrower, or to proceed against or exhaust any security held from the borrower, or pursue any other remedy in the bank's power. By such waiver the guarantor cannot be construed to have waived his right under the well established rule of law that a cause of action must first exist against the principal before an action can be brought against the guarantor. The reason for such a rule is obvious. A surety or guarantor has the right, upon the payment of the debt, to be subrogated to all the rights of the creditor, and to proceed at once to collect it from the principal. If the creditor has tied his own hands by an extension, then the hands of the surety or guarantor are equally bound (50 Am. Jur. 945).

3. The question of prematurity is not moot. The Appellee overlooks the fact that the question here is whether or not a cause of action existed *at the time the complaint was filed.* That no cause of action existed at that time has been clearly established and the District Court was without jurisdiction to render a judgment in favor of the Appellee.

## II.

### Answer to Appellee's Argument That the Flaw in the Description of the Note's Date in the Guaranty Is Immaterial and Does Not Render the Complaint Insufficient.

1. This contention has two aspects. We have contended:

a. That the guaranty was executed November 13, 1942, five days before the underlying note was executed, and that in the absence of some allegation in the complaint explaining the discrepancy, or alleging that they were executed as a part of the same transaction, the pleadings are defective and insufficient to support a judgment.

b. That the guaranty executed November 13, 1942, according to its own terms, related to a "note of even date." The note described in the complaint is dated five days later. In the absence of any allegation in the pleading explaining this discrepancy, the pleadings are defective, and a Motion to Dismiss should have been granted. Since the Court refused to grant such motion, these pleadings cannot now support the judgment.

2. Appellant accepts the rule set forth in the case of *Snow v. Holmes,* 71 Cal. 142, 11 Pac. 856, and other cases cited by the Appellee, but such rule does not aid Appellee. The following observations should be made in regard to the *Snow* case. First, the mortgage was executed subsequent to the note and therefore a primary obligation existed at the time of the execution of the mortgage. The only "mis-description" was in the mortgage which re-

ferred to a note with a date different from that of the note set out in the complaint. In contrast, the instant complaint referred to a note with a date different from that of the note set out in the complaint. In contrast, the instant complaint refers to a guarantee dated *prior* to the note it purports to guarantee. Furthermore, the guaranty itself refers to a note "of even date" rather than the note referred to in the complaint.

Second, there was an *amended* complaint in the *Snow* case. The original complaint set forth the note and mortgage without any explanation of the discrepancy in dates. The amended complaint explained the discrepancy. If the District Court here had granted Appellant's Motion to Dismiss without prejudice to the Appellee to file a new action; if Appellee had filed a new action dated subsequent to the date of the termination of the Joint Adventure Agreement; and if the new complaint so filed had contained allegations explaining the discrepancy and an allegation that the note and guaranty were a part of one transaction, then such complaint might have given the District Court jurisdiction to render judgment in favor of Appellee. The fact is, however, that the judgment was rendered on a complaint that did not and could not state a cause of action because of inconsistencies and prematurity evident on its face. Such judgment, so rendered, is void for lack of jurisdiction.

## III.

### Answer to Appellee's Argument That Morrow Consented in Advance, in His Guaranty and in His Letter at the Time the Joint Adventure Was Formed, to the Temporary Waiver of Resort to the Mortgaged Chattels Involved in the Bank's "Consent, etc." The District Court Properly so Found on Overwhelming Proof Although Want of Such Consent Would Not Have Exonerated the Guaranty.

1. We readily concede that the Appellant waived his right to require the bank to foreclose on the chattel mortgage, but by such waiver Appellant did not agree that the bank might enter into a binding agreement with the debtor not to foreclose, for such agreement would jeopardize or destroy the rights of the guarantor in the event of subrogation. There is nothing in the guaranty itself which can be construed as a consent on the part of the guarantor to any extensions by the bank.

2. We have already shown in Appellant's Opening Brief, that the letter upon which Appellee relies [Ex. 1, Tr. of Rec. pp. 43-44] as being an act of the Appellant from which his consent to the extension can be implied, is a letter from Morrow Aircraft Corporation, the debtor, and any representations therein contained are those of the corporation, and not those of the Appellant individually. We have also shown that the letter does not purport to be a consent, nor does it even amount to a request on the part of Morrow Aircraft Corporation for an extension. We have further contended that such letter does not purport to be the consent of the Appellant to the extension, and that its execution, under the circumstances related in our Opening Brief, is not such as to justify the inference of

consent on the part of the Appellant personally. As we have fully developed this argument in our Opening Brief, we refer to it for a more complete statement of our position.

3. Appellee now makes the rather unique and revolutionary argument that a guarantor is not exonerated where the holder extends the time of foreclosure even though the extension be made without the knowledge or consent of the guarantor. This contention is entirely without support and is directly contrary to the provisions of Section 2819, Civil Code of California. In support of this contention, Appellee cites the case of *Mortgage Guarantee Co. v. Chotiner,* 8 Cal. (2d) 110, 64 P. (2d) 138. A careful reading of this case will reveal, however, that Appellee has completely misconstrued the point of the case. In that case, the Chotiner Building Corporation executed a note and deed of trust. The defendants were stockholders of the corporation and executed a written guarantee on the back of the note expressly authorizing extensions without notice. The land underlying the trust deed was sold to a new grantee and the original payee negotiated the note and deed of trust to the plaintiff. The plaintiff, holder, made binding extension agreements with the new grantee of the property without the consent of the maker, or guarantors. Unlike the present case, the guarantors in the *Mortgage Guarantee Co.* case specifically and in writing *authorized extensions without notice* (8 Cal. (2d) 110 at 111) which they were attempting to avoid by parol evidence. The Appellate and Supreme Courts held that the introduction of parol evidence was error. Obviously, the grantors could not claim exoneration as the result of an extension after having specifically authorized the extensions without notice.

It was next argued that the Chotiner Building Corp., the original mortgagor, became a surety after conveying the property to the new grantee, and that the new grantee became the principal debtor. It was argued that there being no express waiver of any extensions without notice on the part of the Chotiner Building Corp., and since the Chotiner Building Corp. was now a surety, consequently an extension without its consent released the Chotiner Building Corp., and that since the Chotiner Building Corp. was released and was the primary debtor upon the obligation guaranteed by the defendants, that the defendants in turn were released. This argument raises a question quite foreign to the discussion here, namely, does the maker of a note secured by a mortgage, become a surety upon the conveyance by him of the security, subject to the indebtedness, to a third person. As to this point there is apparently a split of authority. According to the *Mortgage Guarantee Co.* case the majority rule is that such maker does not become a true surety, and therefore does not enjoy all the rights and privileges of a surety, one of which is to be exonerated in the event of an extension without his consent. The minority rule is to the effect that such maker is a surety, and like a surety or guarantor, is entitled to such exoneration. The case of *Braun v. Crew,* 183 Cal. 728, 192 Pac. 531, which apparently had been the law of California prior to the *Mortgage Guarantee Co.* case, followed the minority rule and was presumably overruled by the *Mortgage Guarantee Company* case. Neither the *Mortgage Guarantee Company* case nor the *Negotiable Instruments Law* have modified in any respect the general

rule that a surety or guarantor is exonerated where the original obligation is altered, or the remedy or rights of the creditor against the principal in respect thereto are in any way impaired or suspended unless the surety knows of the change, and consents thereto.

## Conclusion.

Appellant's position throughout this case may seem highly technical, but many times one who in all fairness and good morals is entitled to relief (and we believe the Appellant here is such) has nothing upon which to rely in a court of law but strict legal defenses. However, Appellant's contentions, though technical, are nevertheless cogent and compelling reasons, we believe, for reversing the District Court.

1. In the first place there can be no doubt but that this action was prematurely brought. No cause of action existed against the Appellant at the time the complaint was filed. To ignore this fact, or to gloss over it is to do violence to the sanctity of legal principles which guide both courts and lawyers.

2. There is a material and fatal inconsistency in the pleadings in this case in that it is alleged in effect that the Appellant guaranteed payment of a note dated November 13, 1942, whereas elsewhere in the complaint it appears that the note upon which the Appellees have relied is dated November 18, 1942. There is no allegation which in any way explains or attempts to explain this inconsistency. The pleadings are therefore defective and cannot support the judgment. To ignore this defect in the pleadings is likewise to do violence to the sanctity of the law.

3. It is universally held that a guarantor is exonerated where there is a material alteration of the original indebt-

edness or the remedies or rights of the creditor against the principal has been impaired or suspended unless the guarantor knows of the change *and consents thereto.*

4. Although the Appellant had knowledge of the extension, he did not expressly consent to the alteration and consent, if it is to be found at all, must be implied. The only act from which it may be implied is the letter [Appellee's Ex. 1, Tr. of Rec. pp. 43-44], which was signed by Appellant as president of the debtor corporation. The courts have implied consent only in cases in which the conduct of the guarantor has been affirmative and where it has been such as to estop him from denying consent. The conduct must be such as to mislead the creditor, and the creditor must reasonably rely upon this conduct. In the present case, the bank, through its own representatives, arranged the entire transaction of which the extension was a part, and the bank further undertook to prepare and get together all the papers and documents necessary to carry it into effect, but nothing was done to obtain Appellant's consent. In this they were not misled, nor did they rely upon any conduct of the Appellant. Consent, therefore, cannot properly be implied.

The obligation of a guarantor has always been *strictissimi juris.* In the light of the foregoing, the judgment of the District Court cannot be supported and must be reversed.

Respectfully submitted,

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*Attorneys for Appellant.*